FILED: APPELLATE DIVISION - 1ST DEPT 12/15/2023 09:06 PM 2023-03409
NYSCEF DOC. NO. 26 RECEIVED NYSCEF: 12/15/2023

To Be Argued By: Roger A. Cooper
Requested Time For Argument: 15 Minutes

Appellate Division First Department No. 2023-03409
New York County Clerk's Index No. 653284/2011

New York Supreme Court
APPELLATE DIVISION — FIRST DEPARTMENT

LEHMAN BROTHERS INTERNATIONAL (EUROPE)
(in Administration),
Plaintiff-Appellant,

– against –

AG FINANCIAL PRODUCTS, INC.,
Defendant-Respondent.

BRIEF FOR DEFENDANT-RESPONDENT

CLEARY GOTTLIEB STEEN & HAMILTON LLP
Lev L. Dassin
Roger A. Cooper
Rishi Zutshi
Lina Bensman
One Liberty Plaza
New York, New York 10006
212-225-2000
ldassin@cgsh.com
racooper@cgsh.com
rzutshi@cgsh.com
lbensman@cgsh.com

Attorneys for Defendant-Respondent

TABLE OF CONTENTS

Page

Page

<u>TABLE OF AUTHORITIES</u>

<u>Page(s)</u>

<u>Cases</u>

<u>Other Authorities</u>

PRELIMINARY STATEMENT

This case involves a straightforward contract dispute. The Trial Court held a trial to decide the answer to one question: whether Assured "reasonably determined" how much it was owed after LBIE defaulted on twenty-eight bespoke credit default swap transactions (the "Transactions").[1] After conducting a five-week trial, hearing testimony from eleven witnesses, reviewing thousands of pages of exhibits and hundreds of pages of post-trial briefing, the Trial Court ultimately issued a well-reasoned thirty-six page opinion in Assured's favor, holding that Assured's calculation was reasonable and that LBIE did not meet its burden to prove otherwise.

As the Trial Court found, Assured followed the clear and unambiguous terms of the parties' agreement, particularly the "Loss" provision of the 1992 ISDA Master Agreement, which addressed how Assured was to calculate its Loss in these circumstances. Assured calculated the value of its Loss by solving for the "loss of bargain" it suffered as a result of LBIE's default, and did so in a way that accounted for the actual economic bargain the parties struck and relevant market conditions at the time of the termination. The parties' economic bargain was clear:

---

[1] Plaintiff-Appellant Lehman Brothers International (Europe) (in administration) is referred to throughout as LBIE; Defendant-Respondent AG Financial Products Inc., together with its affiliate Assured Guaranty Corp. ("AGC"), which guaranteed the relevant contractual obligations, are referred to as Assured; and the court below is referred to as the Trial Court.

in exchange for fixed premium payments from LBIE, Assured agreed to make payments to LBIE to cover any shortfalls of principal or interest payments as they became due on the securities referenced by the Transactions. The Trial Court correctly found that nothing in the parties' agreement obligated Assured to make payments based on market-price fluctuations; that market prices during periods of market dislocation (such as 2009) do not reliably predict actual performance; and, in any event, that there were no market prices at the time for the Transactions. As a result, the value of the Transactions to Assured depended on how the insured securities performed—not on any market prices. Using its ordinary-course-of-business models and a well-established discounted cash flow analysis, Assured determined it suffered an aggregate loss when LBIE defaulted because LBIE would have owed Assured more in unpaid premiums than Assured would have owed to LBIE.

On appeal, LBIE makes a series of convoluted arguments that mischaracterize the key terms of the parties' agreement, well-settled New York law and other legal precedents, the law of the case, the evidence at trial, and the Trial Court's findings. LBIE's arguments should be rejected, as the evidence and the law clearly support the Trial Court's decision.

First, LBIE gets the law wrong in arguing that it requires Assured's calculation to be based on market prices. LBIE Br. 28-41. The Trial Court's prior ruling on summary judgment, which this Court upheld, rejected LBIE's argument and established that the contract gave Assured, as the non-defaulting party, the discretion to calculate the amount owed to it in the event of a default by LBIE "without reference to market prices." A-62. That holding is law of the case and is supported by the express language of the contract, New York law, and substantial case law and other authorities addressing the Loss provision in the 1992 ISDA Master Agreement.

LBIE also gets the law wrong when it tries to fault the Trial Court for considering relevant facts and circumstances, such as the economic terms of the Transactions and market conditions at the time of termination. LBIE Br. 42-48. New York law is clear that reasonableness must be assessed based on the facts and circumstances of the case. LBIE's handwringing that the Trial Court's decision somehow "upsets" the entire credit default swap ("CDS") industry is similarly unfounded. LBIE Br. 1. The Trial Court's decision applied settled law holding that the Loss definition in the ISDA Master Agreement grants flexibility and discretion to non-defaulting parties to determine their losses and that those determinations will be upheld, provided they are reasonable.

On appeal, LBIE effectively asks this Court to assume that there was a "uniform or highly consistent industry practice" that required Loss to be based on market prices. LBIE Br. 6. But that was precisely the fact question that required a trial and, at trial, the Trial Court found LBIE "came nowhere close" to proving that any such uniform practice existed. A-104. Lacking any systematic evidence or analysis, LBIE relied at trial on its experts' speculation and say-so to try to demonstrate this purported market practice, which the Trial Court thoroughly addressed and found did not credibly or reliably support LBIE's claims. Notably, to the extent LBIE's experts had any experience calculating Loss, they themselves had actually departed from the purported universal market practice. And LBIE did not present a single example in which its theoretical pricing model was used to calculate Loss for transactions with economic terms similar to those here in a functioning market, let alone during a period of market dislocation. The irrelevant examples LBIE did point to included confidential cherry-picked settlements it and its affiliates negotiated for transactions with materially different terms.

LBIE also wrongly asks the Court to assume that "the market value of the Transactions was $485 million in LBIE's favor." LBIE Br. 6. But the Trial Court rejected LBIE's valuation as unsupported by the evidence and unreasonable. The Trial Court held that "the evidence at trial demonstrated a total lack of a market for the securities at issue in this case" and that LBIE merely put forward "a hypothetical market price based on various pricing proxies" using a model that its experts "created out of whole cloth" for this litigation. A-106. The Trial Court further concluded that "LBIE's valuation was commercially unreasonable" in this case because the pricing proxies it put forward reflected market dislocation at the time and not the actual economics of the Transactions, which were heavily customized and only required Assured to make payments for shortfalls that occurred on the referenced securities as they came due over the life of the Transactions. A-108.

Finally, LBIE attacks Assured's calculation as being "based on subjective assumptions that were either wholly unsupported by the record evidence or contradicted by every independent projection in the record." LBIE Br. 6. But the Trial Court rejected that argument based on extensive evidence to the contrary. As a monoline insurance company, Assured was in the business of projecting future losses on financial instruments it insured and had a rigorous process for doing so. Assured valued all twenty-eight Transactions here using the same process and models that it employed in the regular course of its business to value all of its transactions. And Assured's valuation, as the Trial Court found, was consistent with all of the evidence at trial for all twenty-eight Transactions, including LBIE's own admissions that the Transactions were unlikely to "generate any cash for LBIE," A-7854, and the real-world evidence that, when LBIE tried to find a buyer, no one was willing to pay anything to take on LBIE's position in the Transactions and, when Assured held an auction for the Transactions, no one submitted even a single bid.

In sum, the evidence at trial showed that LBIE (not Assured) sought to obtain a windfall by using a litigation-driven hypothetical pricing model that bore no relation to the real-world value of the Transactions to claim hundreds of millions of dollars in damages as a result of its own default. The Trial Court recognized this and—consistent with well-settled New York law, other legal precedents, the law of the case, and all the evidence—correctly held that Assured's Loss calculation was reasonable and that LBIE utterly failed to carry its burden to prove otherwise. For that reason and those set out below, the Trial Court's judgment in favor of Assured should be affirmed.

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Did LBIE meet its burden to prove that Assured's Loss calculation was unreasonable and that LBIE's alternative damages calculation was reasonable?

   Answer: The Trial Court correctly held that LBIE failed to meet its burden.

2. Did Assured meet its burden on its counterclaim to prove that its Loss calculation was reasonable?

   Answer: The Trial Court correctly held that Assured met its burden.

PROCEDURAL POSTURE

I. Summary Judgment

In July 2018, the Trial Court issued a decision granting in part and denying in part Assured's motion for summary judgment (the "SJ Decision"). The SJ

Decision, later affirmed by this Court, dismissed LBIE's claim for breach of the implied covenant of good faith and fair dealing and dismissed LBIE's breach of contract claim based on the design and execution of Assured's Market Quotation auction.[2] With respect to LBIE's sole remaining claim for breach of contract based on Assured's calculation of Loss, the SJ Decision held that Assured, as the non-defaulting party, was free to "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith" and that Assured had the "discretion to calculate Loss without reference to market prices." A-59-60, 62. The SJ Decision held that LBIE raised a genuine question of fact about whether Assured's Loss calculation departed from "standard industry practice," and that a trial was necessary to determine whether Assured's exercise of its discretion "was objectively reasonable" and "made in good faith." A-59, 62.

II. The Trial

The Trial Court held a five-week trial from October 18, 2021 to November 19, 2021. During its case-in-chief, LBIE offered a single fact witness (Eduardo Viegas, a former director at PricewaterhouseCoopers ("PwC") which served as administrator for LBIE after it filed for insolvency) and four expert witnesses (Graham Bruce, Chief Executive of Ainigma Group; Leslie Rahl, Founder and

[2] LBIE's other breach of contract claim relating to Assured's termination of certain CDS in December 2008 was dismissed at the pleadings stage. A-29.

Managing Partner of Capital Market Risk Advisors; Evy Adamidou, a consultant; and Peter Niculescu, Partner at Capital Market Risk Advisors). Assured offered three fact witnesses (Benjamin Rosenblum, the Chief Actuary of Assured; Rob Bailenson, the Chief Financial Officer of Assured; and Michael Schozer, the former President of Assured) and three expert witnesses (Joshua Cohn, Managing Principal of JBHS LLC; Craig Pirrong, Professor of Finance at the University of Houston; and David Prager, Managing Director at Kroll, LLC). The Trial Court also permitted LBIE to present a rebuttal case, during which it introduced additional testimony from two of its expert witnesses (Bruce and Niculescu). In total, the parties introduced more than 300 exhibits, totaling more than 12,000 pages.

The parties submitted two rounds of post-trial briefing (roughly 300 pages in total) and fifteen pages of supplemental briefing at the Trial Court's request on discrete questions relating to the effect of rejecting LBIE's valuation.

III. Decision After Trial

In a detailed, methodical, well-reasoned, thirty-six page decision, the Trial Court ruled that Assured's calculation of Loss was "objectively reasonable and made in good faith." A-76. On LBIE's breach of contract claim, the Trial Court found that LBIE failed to prove there was a standard market practice from which Assured's conduct departed and that "LBIE's valuation, [which] relied entirely on market prices its experts constructed for this litigation, was insufficient to meet LBIE's burden to prove its own calculations were reasonable." A-77. On Assured's counterclaim, the Trial Court found that Assured met its burden to show that its conduct was "commercially reasonable and in good faith." A-79.

COUNTERSTATEMENT OF THE CASE

I. The Parties

Assured. Assured is a monoline insurer. A-6834-36. This means it is in the business of guaranteeing the payment flow of insured securities as those payments come due in return for regular, fixed, premium payments. A-6834-36. Assured offered this protection to counterparties under financial guaranties, or through its subsidiary, AGFP, under bespoke CDS. A-1694-95.[3]

Lehman Brothers International (Europe) (in administration) ("LBIE"). LBIE, a foreign subsidiary of Lehman Brothers Holdings Inc. ("LBHI"), was a broker-dealer that, among other things, bought and sold CDS. A-8429. On

[3] The Transactions here were CDS with bespoke terms that imposed economic obligations on Assured identical to the obligations it undertakes in financial guaranties. A-3777. Additionally, because AGFP was thinly capitalized, had no employees, and no credit rating of its own, A-2733-34, the parties' economic arrangement depended on AGC (identified in the parties' agreement as AGFP's Credit Support Provider) issuing a financial guaranty policy guaranteeing AGFP's payment obligations. That policy was expressly incorporated into the agreement between LBIE and AGFP, which includes the 1992 ISDA Master Agreement, the schedule thereto, and all confirmations thereunder (together, the "Agreement"). A-7166.

September 15, 2008, LBHI declared bankruptcy in the United States and LBIE entered administration in the United Kingdom. A-8429, 702-03.

II. The Transactions

Under the terms of the Transactions, "LBIE would make premium payments to Assured in return for Assured covering shortfalls of principal or interest as they became due on" senior tranches of various underlying reference obligations. A-79. Each of the Transactions' underlying reference obligations is an asset-backed security ("ABS"). An ABS is a security whose payments are generated with cash from collateral assets. A-352. For example, a residential mortgage backed security ("RMBS") is an ABS that allows investors to purchase an interest in the payment stream generated by aggregated mortgage payments in an underlying pool of mortgages. A-352-53. Fourteen of the twenty-eight Transactions reference UK RMBS, eleven reference collateralized loan obligations ("CLO"), one references a collateralized debt obligation ("CDO"), and two reference baskets of twenty U.S. subprime RMBS (instead of a single security) that were included in the ABX 2006-02 and 2007-01 indexes ("ABX"). A-80-81. The RMBS in the ABX baskets were composed primarily of mortgages originated in 2006. A-7248-82, 7366-408, 1203-07.

A. Assured's CDS Were Not Standard Or Easily Tradeable

The Transactions had "bespoke (monoline specific) terms" that were different from the standard terms of most CDS. A-105. First, as the Trial Court found, "Assured did not insure the value of the Transactions. It insured their payment flow as payments became due." A-78. Under this "pay-as-you-go" structure, Assured's only obligation to LBIE was to pay actual shortfalls, if there were any, in interest and principal payments owed under the reference obligations, as those payments came due. A-2812-13, 2831, 2863-64, 2868. As a result, Assured might not owe any payments to LBIE until decades in the future, if at all. A-1696-97, 3964. Second, the Transactions also did not provide for "physical" or "cash" settlement—which apply to most other CDS and expose a protection seller to changes in the market prices of the reference obligations. A-2813-14. Finally, unlike 97% of CDS, the Transactions did not require Assured to post collateral based on changes in the market prices of the reference obligations. A-7051, 1465, 5431-32. Assured's Chief Actuary, Ben Rosenblum, explained at trial that "AGFP, much like AGC, did not trade in and out of the CDS market," unlike hedge funds and banks. A-1699. Assured's business model was to sell protection, whether in financial guaranty or CDS form, and to hold those contracts to maturity. A-2731-34, 2911, 7852.

B. Structural Protections In The Transactions

As the Trial Court found, LBIE did not "address" the "significant structural protections" in the Transactions that made it highly unlikely that Assured would owe payments to LBIE. A-110. For the ABX, Assured only guaranteed what are called the "last-cash-flow AAA" tranches, which would not incur losses until "junior tranches had suffered their losses entirely and had entirely been written down to zero." A-3959, 1201-02. There were also several layers of structural protection before any losses would be incurred on the ABX. First, "each of the mortgage loans [in the ABX] represent only about 80% of . . . the initial value of the home." A-3957. As a result, each loan was originally overcollateralized. A-3957. Second, the pools of loans backing each security were also overcollateralized, as the value of the mortgages in the pool was greater than the face value of the securities that were issued. The ABX pools could sustain losses of 5-10% before any ABX tranches incurred losses. A-3958. Finally, the pools generated additional cash flow because the "average interest rate paid on the" ABX was "lower than the average interest rate on the mortgages." A-3959.

The UK RMBS and CLOs had many of the same protections, as well as additional protections. For example, the UK RMBS included a "master trust structure" under which "new loans [were] coming into the pool at all times." A-3960. Those new loans provided "an opportunity on a regular basis to refresh and rebalance the pool," maintaining overcollateralization, additional reserve funds, and equity cushions. A-3960-61.

C. Express Contractual Language That Parties "Need Not" Calculate Loss Based On Market Prices

All twenty-eight Transactions were governed by a 1992 ISDA Master Agreement, which allows parties to choose the provisions that will govern in the event of early termination by selecting from either "First Method" or "Second Method" and either "Market Quotation" or "Loss." Here, the parties selected Second Method and Market Quotation. A-7160.

Market Quotation requires the non-defaulting party to solicit quotations from "Reference Market-makers . . . for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party . . . and the quoting Reference Market-maker to enter into a transaction (the 'Replacement Transaction')." A-7147. But, "[i]f fewer than three quotations are provided, it will be deemed that the Market Quotation . . . cannot be determined," and the non-defaulting party should then calculate its "Loss." A-7148. The Loss provision gives the non-defaulting party discretion to determine its losses, including based on its "loss of bargain," so long as it does so "reasonably" and "in good faith." In doing so, the non-defaulting party "may (but need not)" reference market prices. In its entirety, the Loss provision states:

> **"Loss" means**, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of **an amount that party**

> **reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number)** in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, **including any loss of bargain**, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party's legal fees and out-of-pocket expenses referred to under Section 11. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. **A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.**

A-7147. The Summary Judgment Decision established that Assured was, therefore, permitted "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith." A-59-60.

III. LBIE Defaults

On September 15, 2008, LBIE filed for insolvency protection in the United Kingdom, entered into administration, and stopped making the fixed premium payments it owed Assured under the Transactions. A-81, 995. Assured terminated the Transactions on July 23, 2009. A-7592. Extensive evidence at trial, summarized below, established that the Transactions had no real-world value to LBIE at the time of termination.

A. LBIE's Contemporaneous Admissions That The Transactions Have No Real-World Value

The evidence at trial showed that LBIE's own employees admitted in contemporaneous documents that the Transactions had no real-world value to LBIE. For example, in October 2008, shortly after LBIE entered insolvency, two of its "most knowledgeable" traders prepared a memorandum analyzing the value of the Transactions to LBIE in several possible scenarios and concluded that all scenarios were "unlikely to generate cash for LBIE because of a combination of counterparty risk, non-standard documentation, and overall credit soundness of the short positions." A-925, 7854. LBIE described the hold-to-maturity scenario—which calculated the value of the Transactions based on netting expected "losses versus the cumulative premium owed but not paid by LBIE" over the life of the contracts—as LBIE's "worst case." A-7852-53. This was because the "overall credit soundness of the short positions" meant that the referenced securities were unlikely to suffer significant losses. A-7854.

Additional LBIE memoranda and communications introduced at trial contained similar admissions. A December 2008 LBIE slide deck (prepared by one of the same traders) also admitted that the Transactions' value was "a fraction of any estimate based on standard terms," and that "the appetite for other market counterparts to take over [the Transactions] is severely limited." A-5961. An email later that month from a third LBIE trader warned that the Transactions would be difficult to novate (assign to another party) because of the "non-posting [of collateral] of the counterparty [Assured]," and that a market-based valuation of the Transactions "grossly exaggerates" their value. A-5992.

B. LBIE Tries But Fails To Find Any Party Willing To Step Into Its Shoes

After LBIE's default, Assured considered three options: (1) do nothing, (2) terminate the Transactions, or (3) allow LBIE time to attempt to novate the Transactions to another creditworthy counterparty, with Assured's consent. A-2872. Assured preferred to maintain its bargain, if possible, so it chose to allow time for potential novation, A-2884-85, 2893-94, and informed LBIE that it was "receptive to exploring that option." A-7787.

The challenge, as LBIE acknowledged internally, was the non-standard terms of the Transactions (including a lack of collateral posting), as well as the counterparty credit risk involved in facing Assured. Recognizing this challenge, LBIE designed a complex structure, which it dubbed "Project Rioja," to "transform [its] monoline contract [with Assured] into a standard ISDA contract" that would be more "palatable" to market participants. A-7797. This structure involved creating a special purpose vehicle that would step into LBIE's shoes on the Transactions with Assured, while simultaneously issuing collateralized CDS with standard terms on the same reference obligations to a third-party purchaser. A-5963, 7799. LBIE described this structure as "[a]llow[ing] for the crystalli[z]ation of the mark to market value on CDS Contracts that have remote default risk," and it explained that "LBIE will be cashing this money to the extent that either [Assured] does not default, or the [reference obligations] do not default (or both)—and this is a high probability scenario." A-5965, A-7797. In other words, LBIE reached the same view as Assured: that the reference obligations were unlikely to experience significant shortfalls. This admission is devastating to LBIE's attempt in this litigation to challenge Assured's assessment as unreasonable.

In late 2008 and early 2009, LBIE tried to find counterparties interested in novation. A-7779-86, 886. The only expression of interest came from a trader at Nomura, who (tellingly) had been a trader at LBIE. A-1040. He said he was initially "very interested in the transaction[s]," A-7806, and Nomura signed a confidentiality agreement in December 2008. A-7807. But nothing came of LBIE's attempt to novate to Nomura. A-2893, 2903. And, at trial, LBIE offered no evidence of any party prepared to take LBIE's positions in the Transactions. A-982-83.

C. Anticipating Litigation, LBIE Solicits Indicative Bids

Although LBIE tried to use three indicative bids (not firm bids by parties willing to transact) to provide "market color" of the Transactions' market value, the Trial Court correctly found the evidence showed the indicative bids were nothing more than attempts to "bolster" LBIE's "litigation position against

Assured" and did not reflect the Transactions' value. A-82-83 (citing A-913-14).

First, the evidence showed that LBIE started looking for indicative bids only after its attempts to solicit firm bids failed. A-6866, 1064-65. When it became clear that no one would "give [LBIE] a firm quote," LBIE's in-house attorney encouraged its traders to "just ask for [a] quote without specifying firm or indicative," because "[f]or purposes of challenging [Assured's] valuation, even indications should help." A-5994, 1052.

None of the parties that provided an indicative bid "was actually willing to make a binding offer." A-82. LBIE's own exhibits revealed what the Trial Court found to be "hesitation on the part of" the would-be bidders. A-82-83 (citing A-8487-98). For example, Citi's trader emphasized that "[a]ll bids are subject to a satisfactory counterparty and variety of internal approvals within Citigroup." A-8485. JPMorgan similarly warned that its indicative bids were "contingent on us knowing and agreeing [to the] counterparty and getting legal to check [that] confirmations are in line with what JP Morgan uses." A-8482.

The third bid, which was received from Nomura, did not "purport any degree of accuracy in these levels" and asked LBIE to "please bear in mind that these are not firm protection bids[,] . . . that none of these prices are actionable" and that "[t]his is not an offer or an invitation to trade." A-8488. Even though the Nomura trader submitting the bid was another former LBIE employee—who analyzed the Transactions while at LBIE, A-7852, and as the Trial Court noted, "must have known Assured was the counterparty," A-83—Nomura's bid warned that "prices might differ substantially once we know the exact identity of our potential source of protection." A-8488.

IV. Assured Terminates The Transactions

After unsuccessfully attempting to engage LBIE in settlement negotiations, Assured delivered a notice of termination to LBIE on July 23, 2009 (the "Early Termination Date") and followed the post-termination process established in the ISDA Master Agreement.

A. Valid Market Quotation Auction Does Not Yield A Single Bid

After terminating the Transactions, Assured engaged Henderson Global Investors Ltd. ("Henderson"), a leading financial advisor, to design and execute an auction of the Transactions as required under the ISDA Market Quotation process. A-41. Henderson invited twelve bidders, all major financial institutions, to participate. Eleven executed confidentiality agreements identifying Assured as the counterparty to the Transactions, and eight entered the data room that contained detailed information about the Transactions. A-6758. But not one bidder was willing to pay a single dollar to step into LBIE's position in the Transactions. Bidders chose not to bid based on concerns similar to those LBIE identified in its internal analysis, including because of a lack of demand for the protection and a lack of appetite to enter into uncollateralized trades facing either Assured or monolines more generally. A-6056, 6070-72, 6079.

Although LBIE tried to dismiss the auction as a mere pricing exercise, the Trial Court rejected that argument at Summary Judgment after finding that LBIE failed to challenge "in any material respect" Assured's proof "that the structure and design of the auction was reasonably calculated to increase the likelihood that the Market Quotation process would be successful." A-48. Because there was no party willing to take LBIE's place and make periodic premium payments in exchange for protection on shortfalls in the underlying securities, Assured could not preserve the benefit of its bargain by entering into replacement transactions.

B. Assured Calculates Its Loss As Loss Of Bargain

The financial consequence of LBIE's default for Assured was that it would no longer receive premiums from LBIE over the life of the Transactions and would no longer have to make floating payments in the event of any interest or principal shortfalls. A-2911. As a result, Assured calculated its loss of bargain by calculating the net present value of these two payments streams (*i.e.*, premium payments and floating payments), which is sometimes referred to as a discounted cash flow analysis. A-7594, 2911. Assured's calculation of the first payment stream was straightforward because the premium amounts were contractually fixed. A-88, 7594. Specifically, Assured determined that the present value of the premiums LBIE would have paid Assured from the Early Termination Date through the end of the life of the Transactions was $35,191,751.62. A-7594. LBIE had also already failed to pay $13,049,366.23 in premiums as of the Early Termination Date, resulting in a total amount owed by it to Assured of $48,241,117.85. A-7594-95.

To calculate the second payment stream, the present value of the floating payments, Assured used the same regular-course-of-business models that its surveillance and loss reserving groups used to estimate expected losses for all of its transactions. A-7595, 2913, 5765. Assured's analysis showed there were no expected losses on twenty-six of the Transactions (all of the UK RMBS, CLO, and CDO Transactions), which continued to be investment-grade during the financial crisis. A-7598-600, 5809-55, 5949-55, 1767-68. This conclusion was consistent with the extensive structural protections in these securities, described above, and with Assured's underwriting analysis, which showed that Assured would not incur a single dollar of loss on the UK RMBS, unless "home prices . . . [had] declined and losses . . . [were] more severe than [anything] ever . . . experienced in the UK market including [during] the bombing of London and the economic fallout around those times," or on the CLOs, unless losses were "two times [historic] averages on the corporate loan losses." A-3962-63, 2794-95, 2819-20.

Assured originally projected no losses on the ABX Transactions, but its updated analysis in 2009, which took into account developments in the housing market and the performance of the mortgages, determined there was the potential for losses. A-5794-804, 1697-1698, 7838-50. As such, these Transactions were elevated to Rosenblum for the calculation of expected losses. A-1760-61. To do so, Assured used the same methodology it used for calculating expected losses on all transactions referencing similar securities (US subprime RMBS). A-1760-61. Assured's model—which was run on the industry-standard Intex platform—relied on three key parameters: (1) how many borrowers in the relevant RMBS pools would default on their mortgages (represented as the cumulative default rate or CDR), (2) how many would prepay (represented as the prepayment rate), and (3) how severe losses on mortgages in default would be (represented as the loss severity). A-1794-95. In each case, Assured set these inputs based on actual market data for the specific RMBS at issue—which was available through Intex. A-1706-07.

Assured then had to apply its judgment to determine how defaults, prepayment and loss severity would evolve over time. A-1760. In doing so, Assured took into account relevant market conditions, including the severity of the downturn in the housing market that had begun in 2007 and the many indications that the housing market was beginning to stabilize, including based on unprecedented government intervention by the Obama administration. A-1728-32.

Specifically, Assured continued to use historically high default rates in its model based on then-current observed data for a period of between twenty-four and twenty-seven months, and determined that, over time, each of the parameters in its model would eventually return to normalized historical levels. A-1606. Based on this modeling, Assured calculated that the present value of the expected losses on the two ABX Transactions would total $27,577,817.65, which it would have been required to pay LBIE. A-7598, 7604, 1761-65. Subtracting this amount from the $48,241.117.85 in unpaid and future premiums owed by LBIE resulted in a Loss calculation of $20,663,300.20 owed by LBIE to Assured. A-7595, 7603-04, 1761-65.[4] This is the economic loss that Assured suffered as a result of LBIE's default as of the Early Termination Date.

There was extensive evidence at trial showing the reliability of Assured's modeling. First, the judgments that Assured made about how to model losses over time were consistent with those made by other market participants who engaged in similar analysis, including Moody's and Standard & Poor's ("S&P"). A-4371-73. Both expressed the view that housing prices would stabilize in the first half of 2010, consistent with Assured's modeling. A-6326, 6355. Similarly, Moody's, which provided extensive disclosure regarding its methodology, explicitly

---

[4] The original statement of calculations, A-7591-602, contained an inadvertent transposition error, which Assured notified LBIE of in July 2019. A-7603-04, 1763-64, 1833-35.

discussed how seasoning and government programs would curtail the severity and duration of losses. A-6630-31, 4027-28, 4363-66, 4370-72. Additionally, the expected losses that Assured calculated for the ABX Transactions closely tracked the contemporaneous expected loss calculations published by Moody's and S&P for US subprime RMBS of the same vintage: Assured projected 28% lifetime collateral losses, while Moody's projected 30% and S&P 32%. A-4041-42, 6625, 6325.

Second, Assured's models were regularly used for multiple business purposes. Assured relied on the same models: (1) in its underwriting process, where accurate modeling was critical to its decision to enter into new transactions, A-5797, 7842, 2844-46, 2856; (2) after entering into transactions, to monitor their credit quality and determine which transactions required increased surveillance or remedial action, A-6838-39; (3) to determine its regulatory loss reserves for its entire portfolio, including "literally hundreds of transactions" unrelated to this dispute, A-4001, 1563-64, 2913; (4) as the basis for its financial reporting to investors, A-6838-41, 6849-50, 6795-96, 6809-10, 7683, 3772-74, 3798; and (5) as the basis for reporting required by its insurance industry regulators. A-9059, 3772-74, 3871. As the Trial Court found, "accurate modelling was essential to [Assured's] risk management." A-89.

Third, because Assured's expected loss methodology was critical to its business, it was subject to multiple layers of internal and external review. A-1710-14, 4002-03. That process began with "a large Surveillance Department" that continuously worked on loss projections. A-1690-91. Additionally, each quarter, Assured's Reserve Committee updated its loss reserve models in light of recent market developments. A-6838-39, 1687, 1709, 1748. The Reserve Committee consisted of the most senior, experienced personnel at Assured, including its CEO, CFO, Chief Surveillance Officer, Chief Accounting Officer, Chief Actuary, and General Counsel. A-1710-11. The updated models were then reviewed by the Audit Committee of Assured's Board of Directors. A-1711-12, 1715-16. Without the Audit Committee's approval, Assured could not file its Form 10-K with the Securities and Exchange Commission ("SEC"). A-1711-12. Finally, Assured's independent auditor, PwC, also conducted an audit of the loss reserve assumptions and issued an opinion for the Company. A-1715, 3808-09, 4003. The strength of Assured's loss reserving model was critical to its success through the financial crisis. A-2728.

Finally, the methodology Assured used to calculate Loss was consistent with how it described the value of its CDS transactions in the extensive disclosures it filed as a publicly-traded, regulated insurance company. A-3772-74. Assured repeatedly stated that its economic obligations under its CDS transactions were limited to protecting against shortfalls in interest and principal payments on the reference obligations as they came due. A-3777-78, 3973, 1694-96.

V. Financial Crisis And Market Dislocation

There was extensive evidence at trial that during the financial crisis, many securities (including the US subprime RMBS referenced in the ABX Transactions at issue here) were trading at prices substantially lower than their fundamental value. This extreme dislocation in the markets further supported Assured's decision to calculate Loss using a discounted cash flow analysis, which tracked the parties' actual economic obligations under the contracts, rather than by using a model based on dislocated market prices, like the one created by LBIE's litigation experts.

For example, a contemporaneous report from the US Department of Treasury described a then-present "[n]egative [e]conomic [c]ycle" in which "declining asset prices [] triggered further deleveraging, which [] in turn led to further price declines." A-7122-25. A scholarly analysis published in October 2009 (based on prices through June 30, 2009) concluded that "ABX.HE indexes [were] inconsistent with any reasonable assumption for mortgage default rates[.]" A-6385. Tellingly, the number of bids on MarkIT's CDS platform "fell by a third during 2008-July 2009, because there were far fewer market participants[.]" A-85 (citing A-3991-92). LBIE's experts admitted that markets were in disarray. One described the financial crisis as "the largest crisis. . . since the Great Depression."

A-1272. Another acknowledged "severe" market dislocation in early 2009 and that "[m]any market participants, accountants, the financial press, and even the US Congress recognized the extraordinary divergence" between market price and fundamental value at the time. A-7004.

STANDARD OF REVIEW

It is well established that after "a nonjury trial, 'the decision of the fact-finding court should not be disturbed upon appeal unless it is obvious that the court's conclusions could not be reached under any fair interpretation of the evidence, especially when the findings of fact rest in large measure on considerations relating to the credibility of witnesses.'" *Watts v. State of New York*, 25 A.D.3d 324, 324 (1st Dep't 2006) (*quoting Thoreson v. Penthouse Int'l Ltd.*, 179 A.D.2d 29, 31 (1st Dep't 1992), *aff'd* 606 N.E.2d 1369 (1992)). Where, as here, the Trial Court's determinations resolve conflicting expert testimony, its decision should be affirmed when "there is no basis to disturb the trial court's overall finding that [one party's] experts were more convincing than [the other's]." *Matter of Levine v. Seven Pines Assocs. Ltd. P'ship*, 156 A.D.3d 524, 524 (1st Dep't 2017).

ARGUMENT

I. The Trial Court Correctly Held That LBIE Failed To Meet Its Burden To Prove The Unreasonableness Of Assured's Loss Calculation

A. LBIE Misstates What The Agreement Requires, The Issue To Be Decided At Trial, And Applicable Law

On appeal, LBIE tries again to rewrite the parties' Agreement to impose an obligation on Assured to calculate Loss based on market prices. LBIE Br. 29-34. But the SJ Decision, which this Court upheld on appeal, already reached the opposite conclusion. It held that the Loss definition (the governing provision in the Agreement, which is quoted in full above) permits Assured, as the non-defaulting party, "to select any methodology for calculating Loss, so long as such methodology is reasonable and in good faith" and that there is "nothing in the text of the definition of Loss that explicitly mandates any particular calculation method . . . ." A-59-60. The SJ Decision specifically rejected the notion that the Agreement "categorically prohibits" a non-defaulting party "from calculating its Loss without reference to market prices," and explained that "the Loss provision could not be clearer in stating that a party 'may (but need not)' calculate Loss using market quotations of rates or prices." A-60. It concluded: "The Loss provision thus by its terms affords the Non-Defaulting Party the discretion to make the determination as to whether use of market prices to calculate Loss is appropriate in a particular case." A-61. LBIE's argument that Assured's Loss must be "determined by reference to objective market prices," LBIE Br. 29, is contrary both to the plain language of the Agreement and the law of the case.

LBIE's argument also fails to address the substantial authority supporting the holding in the SJ Decision and mischaracterizes a handful of cases as somehow mandating the use of market prices here.

First, LBIE's assertion that the Trial Court's decision after trial is "at odds with every leading federal and foreign court decision interpreting the ISDA Master Agreement" is wrong. LBIE Br. 1. As the Trial Court held, the case law interpreting the Loss definition in the 1992 ISDA Master Agreement (including cases on which LBIE purports to rely) confirms that the Agreement provides the non-defaulting party with "discretion and flexibility in selecting the means for calculating its Loss." A-98 (quoting *In re Lehman Bros. Holdings Inc. v. Intel Corp.* ("*Intel*"), 2015 WL 7194609, at *12 (Bankr. S.D.N.Y. Sept. 16, 2015)). LBIE also ignores case law "holding that it is within a party's discretion <u>not</u> to use market quotations in determining Loss," A-99 (citing *Intel*, at *11), as well as cases in which its own experts put forward, and the courts approved, Loss calculations based on discounted cashflow valuations—the same valuation methodology used by Assured here. LBIE's citation to a few cases that approved the use of market quotations to calculate Loss, LBIE Br. 31, is beside the point: the fact that a court found it reasonable for a non-defaulting party to use market prices in one set of circumstances does not mean that it is unreasonable to use a different methodology in a different set of circumstances.

Second, LBIE cites several cases that do not involve ISDA agreements or interpret similar contractual provisions and that have no application here. LBIE Br. 29-30. *Schonfeld v. Hilliard* addressed how to calculate consequential damages in connection with the plaintiff's loss of "an income-producing asset" (i.e., television programming licenses). 218 F.3d 164, 176 (2d Cir. 2000). *White v. Farrell* addressed whether to measure damages as of the date of the breach of contract to purchase a piece of land or as of the date the land was resold. 20 N.Y.3d 487, 489 (2013). *First Federal Lincoln Bank v. United States* addressed whether damages based on the U.S. government's breach of a merger agreement for which it had previously provided regulatory approval should be measured as of the date of breach or some later date. 518 F.3d 1308, 1316-18 (Fed. Cir. 2008). Finally, *Credit Suisse First Boston v. Utrecht-American Finance Co.* addressed the calculation of damages resulting from the defendant's "failure to deliver an asset" in the absence of an agreed-upon contractual damages clause. 923 N.Y.S.2d 482, 483 (1st Dep't 2011).

LBIE's argument that the Trial Court failed to apply an objective reasonableness standard is also wrong: the Trial Court's decision explicitly applies that standard. A-76 (stating that the issue to be decided at trial was whether

Assured's Loss calculation was "objectively reasonable"). LBIE's argument is based on two false premises. First, LBIE suggests the SJ Decision "mandate[d]" that the Trial Court credit LBIE's "evidence of a 'uniform or highly consistent' industry practice" and find any departure from that purported practice to be unreasonable. LBIE Br. 44. But the SJ Decision said no such thing: it merely held that LBIE had raised a genuine question of fact as to whether there was a uniform industry practice of calculating Loss based on market prices from which Assured departed. A-64. Trial was necessary to test LBIE's evidence, and the Trial Court ultimately found that LBIE "came nowhere close" to proving the existence of such a standard industry practice.[5] A-104; *see infra* 37-45. In any event, even if LBIE had been able to prove that Assured departed from standard industry practice, the SJ Decision made clear that this fact would not be dispositive but would be merely "a factor, among others, to be considered in assessing [Assured's] reasonableness and good faith in calculating Loss." A-65.

Second, LBIE argues that by considering all relevant facts and circumstances, including the economic terms of the Transactions at issue, the

---

[5] Similarly, this Court on appeal merely affirmed that "plaintiff raised an issue of fact as to whether defendant's loss calculation was reasonable and in good faith" and that the SJ Decision "properly considered plaintiff's evidence, including expert reports, in support of its claim that defendant's calculations were not reasonable under the circumstances"—thus requiring a trial for the consideration of that evidence and determination of whether any of it actually supported Plaintiff's claim. A-9527-28.

nature of Assured's business, and market conditions at the time of termination, the Trial Court "turned an objective standard of reasonableness into a subjective one." LBIE Br. 42-43. That is contrary to well-settled New York law and the law of the case. The Court of Appeals has made clear that there is only one reasonableness standard in New York, and that "standard provides sufficient flexibility, and leeway, to permit due allowance to be made . . . for all of the particular circumstances of the case which may reasonably affect the conduct required." *Bethel v. New York City Transit Auth.*, 92 N.Y.2d 348, 353 (1998). Consistent with New York law, the SJ Decision held "[i]t is a basic tenet, applied across a wide range of legal issues, that the question of what is reasonable may require consideration of the facts and surrounding circumstances in the case." A-58. The Trial Court properly considered the relevant facts and circumstances here.

B. LBIE Failed To Prove That Assured's Loss Calculation Was Unreasonable

The Trial Court ruled against LBIE on its claim on three independent grounds: (i) LBIE failed to prove that there was any uniform practice for calculating Loss using market prices; (ii) even if it had, the evidence showed there were no market prices for these securities at the time; and (iii) the hypothetical market prices were, in any event, irrelevant to Assured's loss of bargain. A-103-08. The evidence overwhelmingly supported each of these findings.

1. *The Trial Court Correctly Found That LBIE Came "Nowhere Close" To Proving A Uniform Market Practice*

LBIE's primary argument at trial—as on appeal—was that Assured's Loss calculation unreasonably departed from a purported "uniform market practice of calculating Loss based on market prices" or, where no market prices existed, a uniform market practice of using "theoretical market prices." A-103, LBIE Br. 2, 5, 19, 22, 23, 42, 44-48. After permitting LBIE to present its case over fourteen days of trial, including a rebuttal case following Assured's presentation of evidence, the Trial Court correctly concluded that LBIE came "nowhere close" to satisfying its burden and completely "failed to prove the existence of a uniform market practice of resorting to market prices to determine 'Loss.'" A-103-04.

LBIE's experts performed no systematic study or analysis to support their assertion of a uniform market practice requiring the non-defaulting parties to calculate Loss based on market prices, nor could they point to any. A-420, 2106-07, 2643-44, 1434. And the evidence at trial, including leading treatises and industry reports, overwhelmingly support the Court's conclusion that "particularly at times of extreme market disarray, there was no consensus on valuation methods, because prices became divorced from value." A-104 (citing A-6385). For example, Firth Derivatives Law and Practice states: "Where there is no available market for a replacement transaction, it may not be possible to establish Loss by reference to market price." A-104 (citing A-6885). That and other leading treatises also affirm that Loss does not require the use of market data, A-6903-04. Notably, the Durham treatise, on which LBIE's expert, Rahl, relied, explains that "Loss is a more subjective measure of the value of the transaction and a more subjective determination of the early termination amount because it represents the losses suffered by the non-defaulting party . . . which may be unique to the party." A-6950.[6]

Industry reports by the Counterparty Risk Management Policy Group ("CRMPG")—which LBIE's experts also purported to rely on—further support the Court's finding. The 1999 CRMPG report shows the absence of any industry-wide consensus on how to value terminated transactions, writing that "achieving . . . harmonization to standard industry close-out procedures could take considerable time." A-6218. A later CRMPG report from 2008 shows that no consensus was reached, stating that the subject of close-out methodology led to "lively discussion" of the market's "competing views," which the Policy Group was still attempting "to reconcile." A-7834, A-3623.

Case law interpreting the ISDA Loss provision also supports the Trial Court's conclusion that there was no market consensus on valuation methods (and

[6] These authorities and the other evidence in the record also contradict LBIE's unsupported argument that selecting Market Quotation as the default valuation method in the agreements meant the parties "agreed that a market valuation provided the best, most accurate binding value for any terminated trades." LBIE Br. 32.

therefore disproves LBIE's argument that the Trial Court's decision is an outlier). For example, in *Barclay's Bank PLC v Metcalf & Mansfield* (2011 CarswellOnt 9183 [Can. Ont. Sup Ct]) ("*Devonshire*"), the court "soundly rejected a valuation based on theoretical market prices for similar securities during the same time period of market disruption at issue in this case" and held that a "review of the evidence reveal[ed] that . . . there was no consensus on valuation methods" particularly during periods of market disruption. A-104. The Trial Court found this dispute to be "on all fours with *Devonshire* in all relevant respects." A-106. Similarly, the Trial Court followed *Intel*, where the court found a Loss calculation that was not based on market prices to be reasonable. A-98.

And ISDA itself, which LBIE's own witness referred to as "the voice of the derivatives industry," has never supported LBIE's understanding of Loss. A-457. Instead, ISDA has described the Loss provision as a "general indemnity" for the non-defaulting party. A-6451-52, 6466, 6548-49, 3501-02. As the Trial Court pointed out, the ISDA User's Guide to the 1992 ISDA Master Agreement at issue says "'Loss' is supposed to be flexible, [and] involves more than what a Market Quotation exercise would take into consideration." A-98.

The Trial Court's determination was also supported by numerous academic articles and reports by financial institutions about the financial crisis, which demonstrated that there was debate and a lack of consensus as to whether using market prices was appropriate in a time of extreme market dislocation. A-7036-44, A-6373. For example, the Trial Court cited a 2009 published paper concluding that, at the time, the market prices of the ABX Index were "inconsistent with any reasonable assumptions for future default rates" such that there was "serious doubt on the current practice of using these securities to mark portfolios of subprime mortgages to market." A-104 (citing A-6409-10). The Trial Court also cited reports by the Bank of England and the Bank of International Settlements published in 2008 and 2009, which "identif[ied] factors that 'may limit the usefulness of ABX price quotes for valuation purposes . . . .'" A-104 (citing A-6568, 6281-82).

LBIE's market practice argument was further undermined by the fact that, as the Trial Court found, "LBIE's own experts [had] utilized different valuations in other cases" to determine Loss under the 1992 ISDA Master Agreement. A-104-05. Notably, the Trial Court emphasized that LBIE's expert, Rahl, "did not rely on prevailing market prices" in *Devonshire* and instead used a discounted cash flow analysis like the one that Assured used here, with a "normalized risk premium that did not rely on market prices." A-104. Rahl acknowledged in *Devonshire* that "the disparity between a cash flow valuation and a mark-to-model valuation was quite large and was '**the subject of much debate**'"—which the Trial Court correctly observed, is "the opposite of a uniform market practice." A-104 (emphasis in original).

Similarly, the Trial Court highlighted that in *Bank of New York Mellon Trust Co. v Solstice ABS CBO II, Ltd.*, 2012 WL 13070212, at *7 (S.D.N.Y. Mar. 28, 2012), "LBIE's primary valuation expert," Niculescu, had also performed a discounted cash flow analysis to calculate Loss, as Assured did here. A-104-05. As the Trial Court explained, this further "undercuts LBIE's argument that there was a standard practice" of calculating Loss using market prices. A-105.[7]

LBIE also attempts to support its contention that there was a uniform market practice of calculating Loss based on market prices by relying on two documents that reflect settlements that it and its U.S. affiliate reached with certain other counterparties. LBIE Br. 22. The Trial Court correctly found these settlements—which relate to "contracts with materially different terms"—to be irrelevant. A-105. The first document is the Lehman Derivatives Claims Settlement Framework, A-8334-77 (the "Framework") which sets out an approach used by several large banks to resolve claims with LBHI. The Framework does not prove the existence

[7] LBIE admits on appeal that both experts used discounted cash flow analyses to calculate Loss in these prior cases. LBIE Br. 47-48. LBIE retreads its attempts to distinguish *Devonshire* by focusing on Rahl's addition of a "risk premium," but, as the Trial Court observed, the risk premium was added because Rahl was calculating Barclays' loss (the equivalent of LBIE here). A-102. Rahl also calculated Devonshire's loss (the equivalent of Assured) and did not add a risk premium to that Loss calculation. A-102.

of a uniform market practice for several reasons. It was a "strictly private" agreement "for settlement purposes" with parties agreeing to compromise their contractual rights, and even explicitly stated that it "represent[ed] material concessions . . . in the interest of settlement." A-8336. None of the banks that agreed to the Framework were calculating Loss under the 1992 ISDA Master Agreement, and nothing in the Framework even purported to address bespoke transactions like the ones at issue here. A-1467-68. The Framework was confidential until 2011, and therefore could not have been known to Assured in 2009. A-8344-77. And the settlement compromise in the Framework does not even reflect the purported uniform market practice that LBIE claims exists. Instead, the Framework gave LBHI the discretion to disregard the Framework's "proposed claims calculation methodology" and to substitute a subjective valuation if Lehman deemed that price to be unreasonable. A-8336.

The second document, a spreadsheet prepared for this litigation summarizing settlements that LBIE reached with certain other counterparties, is equally irrelevant. A-8507-47, 1092-95. The evidence at trial showed that those settlements involved transactions with materially different terms and economics from the Transactions here. A-4091-92, 6619-24. LBIE also admitted at trial that this spreadsheet excluded instances where its offers had not been accepted due to differences in valuation methodology and approach. A-1128-29, 1123-24, 8397.

Nor did the spreadsheet identify what calculation methodology was used to determine Loss for any transaction at all. A-8507-47. Indeed, at trial, LBIE admitted that the settlement amounts sometimes reflected global compromises that included many different types of transactions. A-1116.[8] Finally, neither the spreadsheet, nor the information contained in it, was available to Assured in 2009. A-1092.

LBIE also falsely claims that it presented evidence at trial of Assured admitting to knowing about a uniform practice of calculating Loss based on market prices. The evidence showed the opposite. First, LBIE misleadingly cites to a sentence from Assured's 2008 10-K containing a disclosure that "[i]f a [CDS] is terminated, [Assured] could be required to make a mark-to-market payment as determined under the ISDA documentation." LBIE Br. 23-24 (citing A-7770). LBIE leaves out the next sentence, which makes clear that both sentences are describing what might happen if Assured were the defaulting party (which is not the case here) and if Assured's counterparties were to exercise their right to terminate their CDS due to a downgrade in Assured's credit rating (which is also not the case here). A-7770. This language does not describe any kind of universal

[8] A-1116 ("Q. You're saying, there may be trades beyond what's accounted for in this spreadsheet that were part of Lehman's assessment of whether the counterparty's valuation was consistent with Lehman's valuation? A. Yes, because they were not trades related to ABS and CDS, and I think . . . even yesterday I said . . . that we've done this analysis on a counterparty-aggregated basis.").

market practice, and instead merely explains one possibility in one scenario (not applicable here) among many.

Second, LBIE points to a slide from a draft presentation to Assured's Board as evidence that Assured "understood that this market practice would also apply even if [Assured] was the Non-defaulting Party." LBIE Br. 24 (citing A-8819). The slide is a comparison of CDS and financial guarantee policies, which notes that for certain CDS, "[m]ark to market may apply." A-8819. During trial, Assured's former President explained that he understood "mark-to-market" on this slide to be a shorthand reference to Second Method/Market Quotation. A-3433. That is, the slide merely reflects the undisputed point that Market Quotation is a mark-to-market concept; it says nothing about what Loss requires or that Assured was aware of a uniform market practice for calculating Loss.

LBIE also points to a slide from a September 2010 presentation to the SEC as evidence that Assured "acknowledged" that a "[r]isk of mark-to-market termination payments exists," but LBIE does not explain how this helps its case. LBIE Br. 24 (citing A-8839). Here, Assured does acknowledge, and has never disputed, that a risk of mark-to-market payments exists under some circumstances—if Assured is a defaulting party, or if it calculates a termination payment pursuant to the Market Quotation provision. Critically, there is nothing in this SEC presentation about the calculation of Loss at all, let alone any evidence of a uniform market practice of calculating Loss using market prices.

2. *The Trial Court Correctly Found That There Were No Market Prices Available For These Transactions And That The Hypothetical Market Prices That LBIE's Experts Created For This Litigation Were Unreliable*

LBIE argues in its appeal, as it did at trial, that Assured's Loss calculation must have been unreasonable because it was not based on market prices. LBIE Br. 28-42. The Trial Court rightly rejected this argument. As an initial matter, the Trial Court correctly held that the argument fails because LBIE "did not even show that market prices were available around the time of the valuation, July 23, 2009." A-78. The Trial Court relied on extensive evidence at trial showing that there was no market demand to assume LBIE's position in these Transactions at any price. This was illustrated by the auction that Assured "conducted properly" following LBIE's default. A-82 (citing A-44-45). Assured (through its financial advisor Henderson) invited twelve bidders, all major financial institutions, to participate. Eleven executed confidentiality agreements identifying Assured as the counterparty to the Transactions, and eight entered the data room that contained detailed information about the Transactions. A-6758. But, as the Trial Court noted "*[n]ot one bid was received*." A-82 (emphasis in original). The Trial Court, weighing all the evidence, concluded the fact "[t]hat no market participant bid at the auction is strong evidence that there was no market and no way of pricing these Transactions." A-106. This was also supported by LBIE's failure to novate the

Transactions to another party, or to get anything other than heavily caveated indicative bids in July 2009. *See supra* 19-23.

LBIE fails to address the unavailability of market prices, which is fatal to its argument. LBIE misleadingly claims that there was trading in the ABX in July 2009. LBIE Br. 41. But the reports LBIE references merely reflect indicative bids and do not account for the bespoke terms of the Transactions. A-3989-90. There were no trading prices available for the Transactions, as proven by the lack of bids at the Market Quotation Auction and LBIE's failure to novate.

LBIE also misleadingly cites an internal Assured spreadsheet reflecting calculations made as part of Assured's GAAP accounting analysis to argue that Assured valued the Transactions at $216 million in LBIE's favor, but that argument entirely misconstrues the evidence. LBIE Br. 42. As the Trial Court correctly found, the accounting analysis, reflected in this and similar spreadsheets, was prepared "for a completely different purpose" to "comply with GAAP for reporting obligations." A-108. The evidence at trial made clear that the analysis LBIE references did not reflect the "ultimate economic or expected loss" of the Transactions or even the ultimate GAAP reported number. A-3787-88. LBIE similarly argued at trial that Assured's disclosure for accounting purposes of its CDS's mark-to-market value revealed that Assured also valued its CDS through a mark-to-market lens, but the Trial Court found the argument "misse[d] the point."

A-108. As investors and analysts alike understood, these numbers were "not meaningful at all." A-3784. Assured explained in its public filings that "[c]hanges in the fair value of [Assured's] credit derivatives that do not reflect actual or expected claims or credit losses have no impact on the Company's claims paying resources, rating agency capital or regulatory capital positions." A-6853. In other words, the mark-to-market changes noted for regulatory-required accounting purposes had "no cash flow effect." A-6847, 3782-84.[9]

LBIE also conflates the hypothetical prices and pricing proxies put forward by its valuation expert, Niculescu, with actual market prices throughout its brief. LBIE effectively asks this Court to assume that LBIE satisfied its burden to put forward evidence of reliable market prices. But the Trial Court correctly rejected the model propounded by Niculescu solely for this litigation, finding that it was "created out of whole cloth" and "attempted to calculate a hypothetical market price based on various pricing proxies," and that it "has no application to the real

[9] In S&P's 2007 Global Bond Insurance Book, which explains the criteria and methodology it uses to evaluate bond insurers, A-6163, it explains that the concept of mark-to-market accounting under FASB No. 133, "insofar as it relates to the financial guarantee insurance industry, has introduced an element of earnings volatility that has little bearing on either the likelihood of a potential claim or the or the intrinsic earnings power of a bond insurer . . . . Unlike other financial sectors for which FASB No. 133 may be more relevant, bond insurers' contracts are not traded, and there is no business intention to realize gains . . . . We believe that the insurers' loss reserves are the more appropriate indicators of potential claims . . . ." A-6167.

world at the time." A-106.

Not only is the Trial Court's assessment of Niculescu's credibility entitled to deference under this Court's precedents, *see supra* 31, but the overwhelming evidence at trial supported the Trial Court's conclusion that Niculescu's model was not reliable.

First, the hypothetical market prices generated by Niculescu for this lawsuit bear no relation to any gain realized by Assured. Niculescu failed to reconcile his model with the extensive evidence that no one was willing to pay Assured anything to step into LBIE's position in the Transactions, either through the market quotation auction or LBIE's novation attempts. Niculescu testified that his model attempted to calculate the price "a disinterested third party would pay or receive in a competitive market to step into LBIE's shoes as AGFP's counterparty with respect to the transactions." A-2247. But the trial evidence shows that when both LBIE and Assured approached some of the most sophisticated financial institutions in the world, many of whom published regular updates on the markets for CDS on asset-backed securities, no one was interested in the Transactions. If Niculescu's modelling were accurate, then it is inconceivable that those institutions would have passed on transactions that would have made them hundreds of millions of dollars. A-4135, 4627. The only reasonable inference, as the Trial Court correctly concluded, is that LBIE's model was not reliable.

Second, Niculescu's model ignored all of the evidence of how LBIE itself priced or valued the Transactions. The evidence at trial included multiple internal LBIE documents and communications showing that LBIE determined that the Transactions had little to no value for LBIE because of the non-standard terms, such as the pay-as-you-go structure and lack of collateralization. A-925, 7854, 5961, 5992; *see supra* 18-19. Niculescu admitted that he ignored this evidence. A-2206.

Third, the evidence showed that Niculescu's model failed to adequately account for the non-standard terms of the Transactions. At trial, Niculescu conceded that he could not base his model on actual transactions with the same terms because there were none. A-2099. Instead, he created a series of proxies based on prices and other data related to different CDS or securities and applied a series of adjustments based on his own assumptions and judgment. For example, Niculescu was unable to find any market prices for the CDS on CLOs at issue here or even on CDS that referenced other similar CLOs. A-2099. In order to determine his hypothetical valuation for the CDS on CLOs at issue, he used pricing data for an index of CLOs (which included lower-rated CLOs and may not have contained any of the referenced CLOs at all), made assumptions about how to interpolate a price for AAA CLOs like those referenced here, and tried to estimate a price for CDS on those CLOs using data related to CDS on junk bonds (again, an asset class entirely unrelated to those at issue). A-2100-06.

Similarly, the pricing data Niculescu used as a proxy for valuing the CDS on UK RMBS was based on a "benchmark CDS" that lacked pay-as-you-go terms, unlike the Transactions in this case. A-2122-23. These pay-as-you-go terms reduced the price a buyer would be willing to pay for that protection. LBIE's own documents show that it paid premiums for a CDS on a UK RMBS with standard terms that were *four times* larger than the premiums it paid on the CDS protection sold by Assured for the same reference obligation. A-2209, 2118, 2120-22, 6005-48. Niculescu, however, only made a 20% adjustment to the prices of those benchmark CDS to reflect the difference in terms. A-2209. He conceded at trial that he did not make any attempt to reconcile his adjustments with any of this real-world evidence. A-2117-18.[10]

Finally, the Trial Court's conclusion regarding the unreliability of Niculescu's model was further supported by extensive evidence of the extreme market dislocation caused by the financial crisis in July 2009. *See supra* 30-31. As the Trial Court explained: "[T]his court rejects LBIE's contention that there was a standard industry practice to use market prices when the market was in total

---

[10] Niculescu conducted no survey or provided other robust empirical evidence to show that his method of layering proxies upon proxies and adjustments upon adjustments to approximate the value of a CDS was generally used or accepted by other market participants. A-2105-06.

disarray, such that the auction for the very Securities at issue did not receive even one bid . . . . The theoretical prices that LBIE's experts come up with are just that—theoretical. Like the *Devonshire* court concluded, if there is no market for the securities, and dislocation divorces prices from value, then there is no basis upon which to construct a market." A-107.

3. The Trial Court Correctly Found That Hypothetical Market Prices Were Irrelevant To Assured's Loss Of Bargain

The Trial Court also correctly held that the hypothetical trading prices constructed by LBIE's litigation expert were irrelevant to assessing Assured's loss of bargain. The Trial Court's analysis was properly grounded in the facts and circumstances of this case, including the economic terms of the Transactions and how LBIE's default affected Assured.

Based on the plain language of the Loss definition, the Trial Court explained that "it is Assured's Loss that needs to be calculated, not LBIE's." A-105. Contrary to LBIE's argument, LBIE Br. 38, the Trial Court did not merely rely on Assured's status as a monoline, but looked to the actual terms of the Transactions. Based on those bespoke terms, the Trial Court found that Assured's loss of bargain in this case "depended on how the Transactions actually performed." A-108. This was because Assured's obligations under the Transactions were limited to making payments to LBIE for shortfalls on the referenced securities *as they came due* over the life of the Transactions. A-78. Unlike the vast majority of CDS, which are collateralized and include different payment terms, Assured had no obligations to make payments based on fluctuations in the market value of the securities referenced in the Transactions. A-3784, 7051. Nor did Assured trade CDS or make a profit from the movement in the market price of the referenced securities. A-1696, 3800-03. As a result, as the Trial Court explained, using "LBIE's valuation, a contrived proxy for market quotation, actually puts Assured in a worse position than if the Transactions had not been terminated." A-107. This would run contrary to the language of the Loss provision, its purpose as a "general indemnity" for non-defaulting parties, and New York law. *See supra* 39.

LBIE asserts that "not a single court interpreting the ISDA Master Agreement has ever held that the failure of the Market Quotation renders market prices irrelevant." LBIE Br. 36. But this is a red herring. The Trial Court here did not conclude that it was simply the failure of the Market Quotation that made market prices irrelevant. To the contrary, the Trial Court explained that the definition of Loss itself gives the non-defaulting party the discretion to determine its Loss. A-98. And the Trial Court is not alone in drawing the conclusion. As the court in *Intel* explained: "Loss is intended to provide parties flexibility in selecting a method to calculate their Early Termination Payments." *Intel*, at *11.

LBIE's claim that the Trial Court misapplied the "cross-check principle" is also wrong. LBIE misstates both the cross-check principle and what the SJ

Decision said about it. LBIE Br. 33-34. The cross-check principle is the notion (articulated by some foreign courts) that the result of Loss and Market Quotation "may be usefully tested by way of cross-check reference to the other." A-98 (quoting *Anthracite Rated Invs., Ltd. v. Lehman Bros. Fin. S.A. in Liquidation*, [2011] EWHC (Ch) 1822 (Eng.)).[11] And the SJ Decision did not hold that cross-check was law of the case, but instead that there was a triable issue of fact "as to whether the cross-check principle is capable of application to this case." A-68. Consistent with that holding, after hearing the evidence, the Trial Court properly concluded that the cross-check principle has no application here because the Market Quotation failed and the real-world evidence showed no market participant was willing to pay a single dollar to enter into LBIE's shoes on the Transaction. *See supra* 20-24. In other words, there was no reliable market quotation against which to "cross-check" Assured's Loss calculation.

[11] Tellingly, *Intel*, the only U.S. case that LBIE cites to support its cross-check argument, approved a Loss calculation that substantially diverged from market prices. *Intel*, 2015 WL 7194609, at *19. And ISDA itself has rejected the cross-check principle, stating that Loss and Market Quotation "could and *should* produce different results in certain scenarios." ISDA's Amicus Brief in Support of Def. Intel Corp.'s Mot for Summ. J., ECF No. 57-1 at 13, *Lehman Bros. Holdings Inc. v. Intel Corp. (In re Lehman Bros. Holdings Inc.)*, Case No. 13-1340-scc (Bankr. S.D.N.Y. Jan. 20, 2015) (emphasis in original).

II. The Trial Court Correctly Held That Assured Met Its Burden To Prove That Its Loss Calculation Was Objectively Reasonable

A. LBIE Ignores Extensive Evidence Supporting The Trial Court's Holding That Assured's Loss Calculation Was Reasonable

LBIE challenges the Trial Court's conclusion that Assured calculated its Loss reasonably as "unsupported by record evidence." LBIE Br. 6, 49-50. But LBIE fails to address two key factual findings—each based on extensive trial evidence—which support the Trial Court's conclusion.

First, the Trial Court found that Assured calculated its Loss for all twenty-eight Transactions using the same ordinary course-of-business model that its surveillance and loss reserving groups used for multiple critical business purposes unrelated to this litigation. A-89; *see supra* 28-29. In light of this evidence, the Trial Court properly rejected LBIE's criticism that Assured's ordinary-course models were "over-optimistic." LBIE Br. 50. Had its loss reserve models been overly optimistic, Assured would have exposed itself to significant negative repercussions, such as underreporting losses and overpaying on its purchases of RMBS. A-1757-59. As the Trial Court recognized, for a "monoline insurer in a highly regulated industry, accurate modelling was essential to [Assured's] risk management" because it was "in the very business of assessing risk." A-89.

Second, the Trial Court found that Assured's loss reserve methodology was "(1) independent and (2) subject to multiple layers of oversight." A-89. While

Assured's Surveillance Department initially developed the methodology, it was refined based on input and advice from Assured's Loss Reserve Committee, which "determined assumptions, loss scenarios and probability weights that it believed to be reasonable based on past assumptions and current market information." A-89, 1710-14. This methodology was then reviewed by a separate Audit Committee, comprised of independent directors of Assured's parent holding company. A-1710-12. Without the approval of this independent Audit Committee, Assured could not file its 10-K. A-1711-12. Finally, the methodology underwent further review by Assured's independent outside auditor, PwC, as part of a "full audit," in which PwC "would agree with the assumptions" made by Assured's Loss Reserve Committee and "[issue] an unqualified opinion for the company." A-3809. The Trial Court found this testimony by Rosenblum and Bailenson credible and noted that "PwC would have raised a concern somewhere if they had found a problem with Assured's methodology." A-89.

LBIE also argues that the Trial Court erred by determining that Assured met its burden with respect to the valuation of the twenty-six UK RMBS, CLO, and CDO Transactions because Assured "never introduced any evidence" supporting what LBIE describes as "extreme and illogical valuations." LBIE Br. 58. Once again, LBIE ignores the evidence presented at trial and mischaracterizes the Trial

Court's findings. There was overwhelming evidence supporting the Trial Court's finding with respect to the twenty-six non-ABX Transactions.

Rosenblum testified extensively about how Assured evaluated risk and tracked the performance of all of its Transactions, including those referencing UK RMBS, CLOs, and CDOs. A-1682-85, 1705-09, 1761-73. As with the ABX Transactions, before entering into any transaction, Assured's "underwriting" process assessed the quality of the referenced bond or security, including based on actual performance data from trustee reports and Intex. A-1697, 1686-87, 1705-07, 5626, 5630, 5727. Assured sold protection against shortfalls in interest and principal payments only when Assured determined that the risk of such losses was extremely low. A-1697-98. Once Assured entered into a transaction, Assured's Surveillance Department monitored its performance, assigning an internal rating to the bond or security based on the likelihood of losses. A-1683-84, 1705-06, 2809-11. In turn, the Surveillance Department elevated to Rosenblum any transaction that fell below investment grade for separate loss reserve analysis. A-1707-08, 1712-14, 3804-05. Unlike the two ABX Transactions, Assured did not expect transactions that continued to maintain an investment grade rating to experience any losses. 1707-08, 1767, 1772-73, 1776, 1782-83.

During his testimony, Rosenblum specifically testified about an example of a surveillance run for two of the CLO Transactions, explained how the analysis reflected there were no anticipated interest or principal shortfalls through the life of the Transaction, and stated that Assured had done the same analysis for the other CLO and CDO Transactions. A-1769-73, 5809-55. Similarly, Rosenblum testified about a surveillance analysis for the fourteen UK RMBS Transactions and explained how the analysis showed no expected losses. A-1773, 1776, 1779-83, 5949-56. The lack of expected losses on these twenty-six non-ABX Transactions was further corroborated at trial by the testimony of Assured's expert, who highlighted the structural protections in place for these Transactions and how extremely unlikely they were to suffer any losses. A-3960-63, 4071-72.

Despite LBIE's misleading claims on appeal to the contrary, the Trial Court correctly referred to the surveillance run for two of the CLO Transactions, Rosenblum's related testimony about the same analysis that Assured performed for the twenty-six non-ABX Transactions, as well as his testimony about the use of actual performance data and all of the other evidence about the structural protections in place for those Transactions. A-95-97 (citing A-1769-1772, 1782-83, 3957).

In sum, overwhelming evidence supports the Trial Court's finding that Assured met its burden with respect to the valuation of all twenty-eight Transactions.

B. LBIE's Other Criticisms Of Assured's Methodology For Calculating Loss Lack Merit

LBIE's other arguments about Assured's methodology for calculating Loss are similarly unavailing. First, LBIE repeatedly characterizes Assured's loss reserve model as "subjective" in an attempt to argue that it therefore could not be objectively reasonable, LBIE Br. 3, 48-50, but the Trial Court properly rejected this rhetorical argument. As LBIE's own valuation expert conceded at trial, all models require the application of subjective judgment. A-2089-90. This includes LBIE's own litigation model, which the Trial Court found was biased to generate higher losses and ignored evidence to the contrary from Moody's and S&P. A-93-94, 106, 109, 2066-74, 5070-88. What LBIE's criticisms about subjectivity fail to address, and what is at the heart of reasonableness, is the *reliability* of each party's model: LBIE's model was purely hypothetical and was "created out of whole cloth" by its expert for this lawsuit, and there was no evidence it was ever used in the real world by any market participant to value CDS. A-106. In contrast, Assured's model was developed in the ordinary course of its business, used for multiple purposes and subject to multiple layers of independent review and oversight. *See supra* 28-29.

Second, LBIE contends that the Trial Court "mistakenly believed that AGC relied on assumptions or projections supplied by Intex" and that this "mistaken understanding that Intex was the *source* of AGC's assumptions fundamentally undermines its conclusions that AGFP valued the ABX CDS reasonably and in good faith." LBIE Br. 51-52. But this is plainly a misreading of a single sentence in the Trial Court's opinion, and LBIE ignores the opinion's detailed and accurate description of Assured's methodology. The opinion makes clear that Assured relied on data provided by Intex, including "actual performance data for the specific RMBS at issue," but it also recognizes that Assured then "utilized models that its surveillance and loss reserve groups used to estimate expected losses for all of its transactions referencing similar securities" and layered in Assured's *own* judgments based on market factors such as stabilization in the housing market in 2009, government intervention, and seasoning to project expected losses for the ABX. A-90-91. In short, the Trial Court fairly and accurately described the evidence of how Assured applied its own judgments and assessments to the Intex data and, as discussed below, concluded those judgments were reasonable and well-supported.

Third, LBIE repeats a number of nit-picking criticisms regarding the appropriateness of specific judgments that Assured made as part of its methodology, including with respect to default rates, loss severity, and prepayment rates. LBIE Br. 52-54. The Trial Court properly rejected these criticisms because the evidence at trial showed that they are based on LBIE's experts mischaracterizing certain trial exhibits and ignoring other unfavorable exhibits.[12] More fundamentally, the Trial Court relied on extensive evidence at trial showing that Assured's judgments were grounded in empirical data and observable economic developments at the time. This included signs of recovery in the housing market, massive government intervention, including programs launched by the Obama administration to decrease borrower defaults, and what Moody's described as "burnout/seasoning" (i.e., the fact that borrowers who stayed current on mortgage payments through the height of the financial crisis were less likely to default in the future). A-109. As the Trial Court observed, A-102, the reasonableness of these judgments is further confirmed by the fact that the only two independent rating agencies that disclosed their methodology, Moody's and S&P, made similar assessments that housing prices would stabilize in the first half of 2010 and seasoning and government programs would lead to reduced "current

[12] For example, LBIE criticizes Assured's loss severity rate, LBIE Br. 53-54, but extensive trial evidence showed that Assured's loss severity rate was in line with the market, and its initial loss severity was "right in the middle of the pack." A-4026-27. Similarly, LBIE's complaint about Assured's default rate inputs relies on an apples-to-oranges comparison to a rate that appears in a JPMorgan report, but omits that the cited rate represents the percentage of borrowers anticipated to default over the lifetime of the relevant mortgages, not just the next two years. A-2335-37, 8673-81. And LBIE's criticism about Assured's judgment that prepayment rates would increase by 2012 makes no sense because it was consistent with well-documented projections that housing prices would have stabilized by that time, A-1689, 4026-27, 6355, and because it actually worked in LBIE's favor. A-1623, 1746-47.

cumulative loss forecasts" and lower default rates. A-6631, 6355, 4363-72, 4027-28.

Fourth, LBIE's assertion that Assured's projection of 28% lifetime collateral losses for the ABX Transactions "was far more favorable to [Assured] than any other market observer projected at the time" is false. LBIE Br. 54. In fact, Assured's projections tracked closely with the 30% and 32% calculated by Moody's and S&P, respectively, for US subprime RMBS of the same vintage. A-4041-42, 6625, 6325. As the Trial Court found, Moody's and S&P's rates were similar to Assured's rate, and supported the reasonableness of Assured's calculations. A-109 (citing A-4368). LBIE's continued self-serving attempts to ignore Moody's projections based solely on the fact that they were published four months before the valuation date makes no sense. LBIE Br. 55. As the Trial Court noted, Moody's calculated the exact same level of losses for these securities in its August 2009 report. A-93, 6362.[13]

LBIE also entirely ignores that Assured's projections were consistent with LBIE's own pre-litigation internal assessments. For example, in October 2008, two of LBIE's "most knowledgeable" traders, A-924-25, prepared an assessment of the Transactions concluding that, because of the "overall credit soundness" of

---

[13] LBIE's own valuation expert also relied on these same Moody's reports. A-2345-46, 5045-46, 5089, 2070, 2069-74.

the underlying Transactions and based on LBIE's internal monitoring, the total floating payments owed by Assured would only exceed the premium payments by between $10 and $21 million if the Transactions were held to maturity. A-7854. LBIE's valuation expert, Niculescu, conceded at trial this internal LBIE valuation could be "fairly characterize[d] as an attempt to do a [] present value of all future losses on the contracts in question" or "as a hold-to-maturity analysis." A-2207. Niculescu even agreed that Assured's Loss calculation was solving for the same question—"what losses Assured would have been obligated to pay if the [Transactions] had been held to maturity." A-2204.

Finally, LBIE argues that the Trial Court improperly disregarded evidence from "leading investment banks," such as Barclays, JPMorgan and Bank of America, based on the Trial Court accepting "unsupported conjecture" that the banks may have misrepresented their forecasts to benefit LBIE. LBIE Br. 56. But LBIE ignores several additional issues undermining the reliability of these reports in this case. Unlike the reports published by Moody's and S&P, these bank reports provide little to no information about their methodology, and therefore no basis for assessing whether their models were reasonable or reliable, much less whether *Assured's* models were reasonable. A-2087, 4395-96, 5142. The evidence at trial showed that the banks' analyses worked backwards from market prices "implied" at the time, and reflected illiquidity and other market stresses, which prevented them from reliably predicting future losses.[14] A-8812, 4388, 4632, 2144, 6388, 6409, 3985-86, 4386-89. And the reports themselves warned that their findings "may not be independent from the proprietary interests of [their] trading desks" and, as a result, may present "conflict[s of] . . . interest." A-8680, 4392. In contrast, the Trial Court found that the "ratings agencies were aligned with neither the banks nor the monolines," were incentivized to be as accurate as possible, "disclosed the methodology behind their projections," and, as a result, produced more reliable projections. A-94.[15]

CONCLUSION

For the reasons above, the Trial Court's judgment should be affirmed and LBIE should be ordered to pay Assured's costs and attorneys' fees pursuant to the parties' Agreement.

---

[14] The Barclays bank report that LBIE points to actually supports the existence of dislocated market prices, as evidenced by divergent housing price appreciation rates for each of the four vintages of the ABX index. A-8812.

[15] LBIE tries to twist the Trial Court's words as discrediting the ratings agencies for "failing to predict the financial crisis," LBIE Br. 55, when the Trial Court in fact acknowledged that the ratings agencies were incentivized to "be correct" given their "prior mistakes," "had nothing to gain from putting forth a biased viewpoint on the crisis involving RMBS," and most importantly, "disclosed the methodology behind their projections." A-94.

Dated: December 15, 2023
New York, New York

Respectfully submitted,

Lev L. Dassin
Roger A. Cooper
Rishi Zutshi
Lina Bensman
CLEARY GOTTLIEB STEEN &
HAMILTON LLP
One Liberty Plaza
New York, New York 10006
T: 212-225-2000
F: 212-225-3999

Attorneys for Defendant-Respondent AG Financial Products Inc.

PRINTING SPECIFICATIONS STATEMENT

This brief was prepared with Microsoft Word, using Times New Roman 14 pt. font and double line spacing. According to the aforementioned processing system, the portions of the brief that must be included in a word count pursuant to 22 N.Y.C.R.R. § 1250.8(f)(2) contain 13,843 words.

Dated: December 15, 2023
New York, New York

Rishi Zutshi